RISK MANAGEMENT DIVISION
OFFICE OF FINANCIAL MANAGEMENT

Lucy Isaki, Sr. Asst. Director & Legal Counsel

John Nicholson, Risk Management Coordinator

Jolene Bellows, *Spotlight* Editor

Washington State Investment Board Leads the Way to ERM

The Washington State Investment Board began it enterprise risk management (ERM) journey in 2003, backed with a strong commitment from Executive Director, Joe Dear.

WE CAN'T DO OUR JOB IF YOU DON'T HELP US.

ENTERPRISE RISK MANAGEMENT

First, staff conducted an initial assessment, kicking off the discussions of ERM capabilities and effectiveness. The discussions also helped the agency determine how incorporating ERM's focus on self-analysis could help move it further towards being one of the *best agencies in the field of public investment.*

The next leg of the journey in 2004 involved developing the ERM "core" or framework.

EVOLVING ENTERPRISE RISK MANAGEMENT

The spring 2006 edition of Spotlight introduced enterprise risk management (ERM)—the holistic approach to managing risk. This issue continues to explore ERM with a brief review of its beginning and an article that "spotlights" the Washington State Investment Board's journey down the ERM road.

Organizations actually practice various parts of what has become known as *enterprise risk management.* Identifying and prioritizing risks (via foresight or hindsight), treating risks by transferring them—through insurance or other financial means—as well as contingency planning and crisis management are standards in the traditional risk management world.

What has changed is treating a greater variety of risks—moving beyond the typical "hazard" risks facing the organization—to a more holistic range of risks to include financial, operational, and strategic risks. ERM also elevates senior management responsibility, and eliminates the treatment of risks in "silos", but rather as how the "silos" relate to each other and to the organization as a whole.

Some credit the quality management movement for ERM's roots. The earliest foothold for ERM originated in the financial world— where a variety of competing risks are readily identifiable. The Treadway Commission's Committee on Sponsoring Organizations (COSO)—a voluntary private-sector organization formed in 1985 to combat fraudulent financial reporting—produced an enterprise risk management framework. The Information Systems Audit and Control Association (Isaca) developed Cobit (the Control Objective for Information and related Technology), a document that also provides guidelines for establishing an enterprise risk management framework. Both are efforts designed to jump-start the use of ERM in corporations and business.

Critics may be quick to label ERM as another bureaucratic project. Granted, some framework does have to be laid and people involved. However, the organization's risk officer can be a key player in the education process. ERM is *not about creating more work*—just taking a different approach to how things are carried out in the organization. When ERM is done right—it's seamless and hardly noticed. When evolved, risk emphasis and questions come up often and in the course of everyday business, not just when it rises to the top of someone's heap or a crisis is at hand. ERM is on its way when employees *know what to do with risk* and *want* to do it.

Commercial Insurance Update

Umbrella and Excess Insurance— What's the Difference?

To answer a frequently asked question that the Risk Management Division receives, definitions and examples are outlined below.

- **Primary Insurance:** Insurance providing coverage from the first dollar of loss, perhaps after a deductible. *It is the first layer of insurance to be triggered by a covered loss.*

- **Excess Insurance:** A policy designed to provide excess limits of coverage above the limits of a primary insurance policy. May be written as a *following form*, which means it will cover only losses covered by primary insurance. *Excess insurance coverage goes into effect when all primary insurance is exhausted.*

- **Umbrella Insurance:** Liability insurance affording high limits of excess coverage for many liability exposures, including those not covered by primary insurance. *Umbrella insurance may add additional types of coverage over the primary insurance versus excess insurance which only "mirrors" the primary coverage.* Many umbrella policies provide broader coverage than the underlying policy. The term *umbrella* is derived from the fact that umbrella insurance is a separate policy above a primary insurance policy.

Washington State Investment Board Leads the way to ERM *(cont. from page 1)*

This framework was based in part on the internal control for financial reporting guidelines developed through COSO (the Treadway Commission's Committee of Sponsoring Organizations - a voluntary private sector organization dedicated to improving the quality of financial reporting through business ethics, effective internal controls, and corporate governance). Generally, this approach helps an organization focus on defining its basic mission and recognizing what it does well—and what it does not—in striving to accomplish that mission. Risks are seen as *opportunities for success as well as failure,* and then analyzed for how well the organization is prepared to deal with them.

In 2005, the ERM team developed and adopted tools for implementing an initial framework. It also marked the year that Mr. Dear created a new position that recognized the increasing ERM role. Beth Vandehey, CPA, became the WSIB's first Risk and Compliance Director. While acknowledging significant progress thus far, Ms. Vandehey is far more excited about using a mature ERM framework in an agency like WSIB, which straddles the world of private investment firms and public government agencies. Such a framework can bring more dimension to how an organization recognizes and discusses the risks it faces in trying to fulfill its mission for the constituents of the state.

As the ERM approach evolves, its success will depend less on upper management directives. It will shift to individual agency staff members who recognize opportunities for change, and are involved in making those changes work. " Risk management is about the ERM team—working from the bottom up to improve our operations, with leadership and vision from the top down," said Ms. Vandehey.

WSIB's "framework" is comprehensive, outlining *key dimensions*, *principals*, *core business processes*, and *enterprise risks*. Their *key dimensions* cover all aspects of the organization's activities to ensure a comprehensive approach is taken in their risk management program, and includes:

- Globality
- Business Integration
- Human Resources
- Technology
- Reputational and Fiduciary Responsibility
- Investment Management Skill
- Legal and Compliance Environment
- Business Continuity

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In addition their framework outlines:

- 37 Principles - Standards that WSIB strives to achieve
- 25 Core Business Processes – As identified in WSIB's structure
- 43 Enterprise Risks - Common types of risks that are used to assess the *control* structure

WSIB Enterprise Risk Management Framework
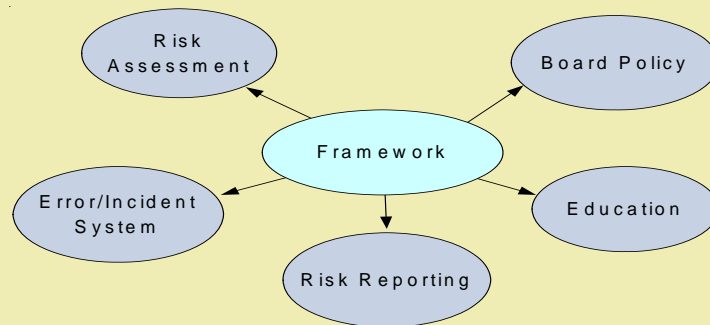
The 12-member "ERM team"—representing a cross-section of agency operations—meets consistently every other week to address the ERM program and review errors/incidents that all employees report via a custom-designed ERM Access database reporting tool.

"If there were any surprises about the ERM process, they came in the form of the unexpected value that happened with increased communication. During this year's benchmarking review of the agency's current risk management activities to COSO's best practices, the team was really hard on themselves, but we all have a better understanding of what we are doing well and what we can improve on," said Ms. Vandehey.

> ### WSIB's Risk Management Motto
> Risk management is a process that has to be continual and evolving in nature so that it remains dynamic and relevant to the business of the agency as the agency changes over time.

Potential risks and actual incidents can be ranked as having a low, medium or high impact on the WSIB, and are categorized within the agency's various main business areas such as investments, accounting or information technology. Assessing the likelihood and impact of each risk helps determine how the risks rank relative to each other and enables the agency to prioritize its efforts on areas for improvement. It also provides a way of understanding which risks are being reduced, accepted, avoided, or shared, and whether those responses are appropriate.

Since coming on line in September 2005, the incident/error database contains about 100 reported incidents. All entered incidents are reviewed by the ERM team and followed up on with final dispositions or actions detailed in ERM reports. As a result many processes have been tweaked to improve quality, which naturally mitigates risk.

Besides creating ERM "dashboard reports" for the executive management team (and available for review by all employees), Ms. Vandehey sees a continuing role at this point for ERM education both from the top and bottom of the agency. While the WSIB ERM program hums along in overdrive, the road ahead for 2006 includes plans for more enhancements based on applicable sections of COSO. Similar agencies in other states, such as California, are just now embarking on the ERM journey.

Ms. Vandehey enthusiastically shares information about her agency's ERM journey with other interested agencies. She can be reached at bvandehey@sib.wa.gov.

CLAIMS CORNER

RMIS UPDATE

The July 17-18 kick-off session for the risk management information systems (RMIS) project— hosted by the Risk Management Division—provided an opportunity to meet Valley Oaks Systems Implementation Manager, Christopher Pham, and to plan for project progression. The team also began discussion on antici-pated RMIS customizing features. In the meantime, RMIS team members are becoming more familiar with the iVOS® application product now installed in OFM's test environment.

While the original date for bringing the new system on-line was customarily overly-optimistic, OFM Project Manager, Doug Selix, and RMD RMIS Product Coordinator, Joan Mackey antici-pate completion of a detailed project plan August. They cautiously estimate system readiness for the first quarter of 2007. In the meantime, important background work continues on data clean-up, and planning for data migration to the new RMIS. Watch for the next RMIS update in the Fall 2006 edition of *Spotlight.*

FAST FACTS

According to an August 2006 news release from the National Highway Traffic Safety Administration (NHTSA), the number of people killed on U.S. roadways in 2005 climbed to the highest level in 15 years, an increase tied to rising deaths among motorcyclists and pedestrians. They also reported that the number of people injured in motor vehicle crashes declined 3.2 percent from 2.8 million in 2004 to 2.7 million in 2005. For more details from the vehicle crash statistics report, visit the NHTSA website at http://www.nhtsa.dot.gov/.

FAST TIPS

New State Workers' Comp Class Reflects Driving Risk

The Department of Labor and Industries (L&I) recently notified state government employers about a newly created workers' compensation risk classification for state government employees—**Class 5300**. Employees with office *and* "administrative field duties" that routinely require travel out of the office must be reported in class 5300 **beginning January 2007**.

L&I responds to frequently asked questions about the new state government risk class below.

Q - *Is driving a factor that should be considered in determining whether an employee should be reported in class 5300 starting in January 2007?*

- The **amount of driving** required in a worker's job can be a factor in applying risk classifications 4902 or 5300.
- If a worker leaves their office site for **more than an occasional** meeting, conference, or errand, then they probably **should be reported in class 5300** instead of 4902.

Q - *What factors should be considered for reporting employees in the new class 5300?*

- Employees whose job duties require them to travel away from the office to complete their work, whether every day, once a week, or when they determine the need exists. They may spend some time in an office completing paper work and doing other administrative work, but their job requires them to travel off-site visiting clients, businesses, employers, or other agency staff.
- It would also apply to someone who works in the office much of the time but will need to travel outside of the office to observe something or gather facts in order to complete some aspect of their job, but who does not have any "hands on" type work (such as driving to a site to gather samples to take back to the office to study.)
- It could also apply to supervisors who have staff at more than one office, and travel by the supervisors between offices that would be anticipated to complete supervisory job duties.
- Examples of class 5300 job titles could include auditor, collector, social worker, and public relations staff.

Q - *What criteria should be considered for continuing to report employees in class 4902?*

- Employees who rarely, if ever, have the need to travel to complete their job. They may need to travel to a location away from the office to attend a conference, an occasional meeting or training, run an errand, do banking or post office duties. They **typically would not have periods of travel away from the office for appointments, meetings, or other engagements**, and normally would not be expected to file expense reports to complete their job.
- It can also include employees with duties that are not strictly clerical in nature, but are performed in an office environment and do not include any physical labor requirements or "hands on" exposure to hazards outside of the office.
- Examples of class 4902 job titles include office assistants, secretary, fiscal analyst, customer service representative.

Q*uestions about the reporting requirement changes?*

Contact L&I's Julia Ehr at 360-902-4799 or e-mail her at ehrj235@lni.wa.gov.